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IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1958.

No. 529.

ALABAMA BY-PRODUCTS CORPORATION,
Petitioner,

versus

GEORGE D. PATTERSON, District Director
of Internal Revenue,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit.

REPLY BRIEF FOR PETITIONER.

WILLIAM BEW WHITE,
2100 Comer Building,
Birmingham 3, Alabama,
Attorney for Petitioner.

Of Counsel:

WILLIAM BEW WHITE, JR.,
EDWARD M. SELFE,
WHITE, BRADLEY, ARANT, ALL & ROSE.

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REPLY BRIEF FOR PETITIONER.

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

1. **This Court is not being asked to review a finding of fact but is being asked to interpret the meaning of the phrases "gross income from mining" and "mineral product of like kind and grade" in the Internal Revenue Code and the Treasury Regulations.**

The Government erroneously seeks to put this case in the context of a burden of proof case by its incorrect

statement of the question presented (Res. Br. p. 2), and incorrectly argues (Res. Br. p. 6) that the courts below made findings of fact which determine the issue. The District Court designated as a finding of fact the finding that there was in 1952 in the Birmingham district a representative market or field price for coking coals of like kind and grade as that used by Petitioner in the manufacture of coke (R. 444). It is quite obvious, however, that such finding is based solely upon the District Court's conclusion of law that all commercially useable coking coals are of like kind and grade. Accordingly, if the District Court is in error in holding that all commercially useable coking coals are of like kind and grade as a matter of law even though as a matter of fact commercially significant differences exist, its finding with respect to a representative market price is based upon an erroneous interpretation of the applicable law and Treasury Regulations and amounts to an ultimate finding of fact based upon an erroneous conclusion of law. Such a finding is a conclusion of law or a mixed question of law or fact which is subject to review on appeal. See *Helvering v. Tex-Penn Oil Co.*, 300 U. S. 481, 491 (1937). An ultimate finding has never been considered within the "clearly erroneous" doctrine of Rule 52 (a) of the Federal Rules of Civil Procedure. *Lehman v. Acheson*, 206 F. 2d 592, 594 (3rd Cir. 1953); *Stevenot v. Norberg*, 210 F. 2d 615 (9th Cir. 1954); *E. H. Sheldon & Co. v. Commissioner*, 214 F. 2d 655 (6th Cir. 1954); See *Galena Oaks Corp. v. Scofield*, 218 F. 2d 217, 219 (5th Cir. 1954). The Government never contended below and the Court of Appeals never suggested that the District Court's finding was one subject to Rule 52 (a) or was not subject to review on appeal.

The dispute in this case requires an interpretation of the term "mineral product of like kind and grade." The Government (Res. Br. p. 7) admits that there are physical and chemical variations in the coking coals in the Birming-

ham district which affect the nature and use of the ultimate product produced with such coking coals. The Government insists, however, that such admitted differences in physical and chemical characteristics do not constitute differences in kind and grade within the meaning of those words as used in the Treasury Regulations. The Petitioner is asking this Court to determine whether the Government's interpretation of such words in the Treasury Regulations is correct and this clearly is solely a question of law and not of fact. In *Wagner Quarries* and other cases cited on page 10 at note 4 of the Government's brief, the courts are concerned with the construction of the term "grade" as it appears in the Internal Revenue Code itself. As we show below, the conclusions reached are in irreconcilable conflict. But that such question of construction presents a question of law and not of fact, there can be no doubt.

2. The decision of the Court of Appeals in this case is in conflict with the decision of the Court of Appeals for the Sixth Circuit in United States v. Wagner Quarries Co., 58-2 U. S. T. C., Par. 9933, 2 A. F. T. R. 2d 6104 (1958), wherein the "suitability for use test" urged herein by the Petitioner and rejected by the Fifth Circuit, as distinguished from the "actual use test", was approved by the Sixth Circuit.

The Government cites *Wagner Quarries* (Res. Br. p. 8) in support of its argument that the end use test has been rejected by the courts. The actual use test has been rejected by the courts but the suitability for use test has been specifically adopted by the courts. The Petitioner relies on the suitability for use test, not the actual use test.

In *Wagner Quarries* the taxpayer claimed percentage depletion under Section 144 (b) (4) (A) of the 1939 Code on all of its limestone at the 15% rate applicable to "metallurgical grade limestone" and "chemical grade

limestone." The taxpayer sold 40% of its limestone for chemical or metallurgical purposes and 60% for agricultural and road construction purposes. The Government contended that the rate of depletion should be based on the *actual use* for which the taxpayer's limestone was sold rather than on the *grade* of the limestone sold, the rate for agricultural limestone (i. e., calcium carbonate) and road construction limestone being 10% and 5% respectively. The District Court held that the depletion rate had to be determined by the grade of the limestone and not by its actual use and held that the terms "metallurgical *grade* limestone" and "chemical *grade* limestone" meant limestone which was *suitable for use* for chemical and metallurgical purposes. It held that the sale of 40% of the taxpayer's production for chemical and metallurgical purposes indicated that all the taxpayer's limestone (including that sold for agricultural and road purposes) was metallurgical and chemical grade limestone regardless of its actual use by the taxpayer's customer.

On appeal the Sixth Circuit affirmed, and rejected the Government's actual use test. It adopted the suitability for use test and found that "... a reasonable interpretation of Congressional intent in using the words 'metallurgical grade limestone, chemical grade limestone', would mean a limestone of high calcium content with a very low silica or impurities percentage capable of use for metallurgical or chemical purposes." The Sixth Circuit thus held that in determining whether a particular limestone was of metallurgical or chemical *grade*, the test is whether the limestone was "*capable of use for metallurgical or chemical purposes.*"

In *Waggoner Quarries* the District Court's determination that the limestone in question was chemical *grade* limestone was based upon the suitability for use test and the appropriateness of the use of that test was a question of

law approved by the Sixth Circuit. In approving the use of such test the Sixth Circuit is clearly in conflict with the Fifth Circuit which has expressly rejected this Petitioner's argument that in determining "gross income from mining" the term "mineral product of like kind and grade" has reference to a mineral product with the same capacity for profitable use (Appendix to Pet. App. pp. 8-10). If it is proper to determine the applicable rate of percentage depletion under Section 114 (b) (4) (A) by use of the suitability-for-use test, it is certainly proper to determine "gross income from mining" under Section 114 (b) (4) (B) by use of the suitability-for-use test. Obviously this must be so since the rate of depletion determined under Section 114 (b) (4) (A) is applied against the "gross income from mining" determined under Section 114 (b) (4) (B) to compute the percentage depletion deduction.

The Government misconceives and therefore erroneously states what end use test has been rejected by the courts. In ascertaining grade under the statute, the courts (now including the Court of Appeals for the Sixth Circuit in *Wagner Quarries*) approve the test of suitability for use. What they have rejected is the effort of the Government to prescribe not only that the mineral shall be suitable for appropriate uses, but also that it shall be actually put to a particular use before it can be eligible for a particular depletion rate.

The Fifth Circuit erroneously construes the Petitioner's position as being based upon the actual use to which Petitioner's coking coals were put (Appendix to Pet. App. p. 11). This is not the Petitioner's contention, but, *on the contrary*, Petitioner contended below, and still contends, that the coking coals sold in the year in question were not of "like kind and grade" to Petitioner's coking coals because those coals sold did not have the same *capacities* for profitable use as the Petitioner's coking coals, and

this regardless of the actual use to which the Petitioner's coking coals were put. Coking coals which are suitable for use in the manufacture of blast furnace coke but which because of their mineral content are *not* suitable for use in the manufacture of foundry coke are obviously not of like kind and grade to Petitioner's coking coals, and yet the Fifth Circuit expressly held that they were of like kind and grade as a matter of law, although the evidence was uncontradicted that as a matter of fact, they were not (R. 435-9). *Wagner Quarries*, on the contrary, expressly holds that mineral content is of critical significance in determining grade.

The Government argues (Res. Br. p. 7) that the differences in the coking coals in question were "minor" but at the same time admits that such "minor" differences affected the nature and use of the ultimate product. This statement is also to be compared with the Government's footnote 4 on page 10 of their brief in which they state that the "grade" cases relied on by the Petitioner turn on the physical and chemical properties of the mineral in question. The decision of the Fifth Circuit is clearly in conflict with the decision of the Sixth Circuit in *Wagner Quarries*, and with the decisions of other courts in the "grade" cases of *Iowa Limestone Co.*, 28 T. C. 881 (1958); *Dixie Lime Products Co. v. United States*, 57-2 U. S. T. C., ¶ 9933, 52 A. F. T. R. 1336 (D. C. Fla., 1957); and *Monolith Portland Cement Co. v. United States*, 58-1 U. S. T. C. 68,248, 1 A. F. T. R. 2d 1512 (D. C. Cal., 1958).

3. The statutory concept of "commercially marketable product," involved in Dragon Cement and related cases, and the Regulations concept of "first marketable product," involved in this case, are the same but the results reached by the Courts of Appeal are in conflict.

The Government asserts (Res. Br. p. 9) that the decisions in *Dragon Cement Co. v. United States*, 244 F. 2d 513 (1st

Cir. 1957), cert. denied, 355 U. S. 833; *Townsend v. Hitchcock Corp.*, 232 F. 2d 444 (4th Cir. 1956); *United States v. Sapulpa Brick and Tile Corp.*, 239 F. 2d 694 (10th Cir. 1956); *United States v. Cherokee Brick & Tile Co.*, 218 F. 2d 424 (5th Cir. 1955); and *United States v. Merry Brothers Brick and Tile Co.*, 242 F. 2d 708 (5th Cir. 1958), cert. denied, 355 U. S. 824, are not in conflict with the present case because such cases involved minerals which were not marketable in mineral form; whereas, they assert, Petitioner's coking coal is marketable in mineral form.

In *Dragon Cement* the mineral involved was calcium carbonate, commonly referred to as limestone. Limestone is obviously highly marketable for many purposes, including use for agricultural purposes, concrete aggregates, ballast and cement. In *Dragon Cement* the taxpayer's limestone could not be sold to a manufacturer of cement because of transportation costs (see 144 F. Supp. at n. 3, p. 914), but it obviously could have been sold for use as road or concrete aggregates or other less profitable uses than the manufacture of cement. The cases of *Iowa Limestone Co., supra*, *Dixie Lime Products Co., supra*, *United States v. Wagner Quarries Co., supra* and *Monolith Portland Cement Co. v. United States, supra*, all involved limestone which was sold for many different uses, clearly indicating that limestone is a very marketable product for many purposes.

The Petitioner urges in this case that it is entitled to compute its "gross income from mining" using the proportionate profits method based upon the gross sales of coke because coke is the "first marketable product" produced by the Petitioner. The Treasury Regulations specifically provide that the proportionate profits method is to be used when the first marketable product produced by the taxpayer is a product other than the crude mineral product. Regs. 118, Sec. 39.23 (m)-1 (3). The concept of "first

marketable product" in the Regulations involved in this case is the same as the statutory concept of "commercially marketable product" involved in the *Dragon Cement* case and related cases but the result reached by the Fifth Circuit in this case is in conflict with the results in other circuits. The Government's effort (Res. Br. p. 9) to show no conflict between the instant decision by the Fifth Circuit and the decisions by other Circuits in *Dragon Cement* and related cases is therefore without merit.

In *Dragon Cement* and the other related cases the mineral product in question was not in fact sold by the taxpayer but rather was converted into a valuable product upon which product the taxpayer was entitled to compute percentage depletion. In the instant case the Petitioner sold only a small portion of its total production in the form of coal, but rather converted its coking coal into high grade foundry coke. The record clearly establishes that the Petitioner was unable to sell its coking coals in the crude mineral stage, the few sales it made being at less than its cost of production, and, therefore, such coking coals were not marketable so far as Petitioner was concerned, just as the limestone produced in *Dragon Cement* was not marketable for cement purposes and was therefore, converted into cement by the taxpayer. There is no question, therefore, that the result reached in *Dragon Cement* and the related cases is in conflict with the result reached by the Fifth Circuit in this case.

CONCLUSION.

The decision of the Fifth Circuit in this case represents an erroneous application of the so-called end use test and a failure to give effect to the first marketable product concept in both of which it is in conflict with decisions by the First Circuit, Fourth Circuit, Sixth Circuit, Tenth Circuit, and is inconsistent with other decisions of the Fifth

Circuit. The issues in this case are of national public importance and should be resolved by this Court.

Respectfully submitted,

WILLIAM B. WHITE,
Attorney for Petitioner.

Of Counsel:

WILLIAM B. WHITE, JR.,
EDWARD M. SELFE,
WHITE, BRADLEY, ARANT, ALL & ROSE,
2100 Comer Building,
Birmingham, Alabama.